

August 03, 2020

Uttarakhand Gramin Bank: Rating reaffirmed and withdrawn; Outlook revised to Negative

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Outstanding
Perpetual Debt Programme	300.00	0.00	[ICRA]BBB-(hyb); Outlook changed to Negative from Stable and rating reaffirmed and withdrawn
Total	300.00	0.00	

*Instrument details are provided in Annexure-1

The rated perpetual debt is eligible for inclusion in the bank's Tier I capital and has specific features, whereby the debt servicing is linked to the bank meeting the regulatory norms for capitalisation and reported profitability. As per the regulatory norms for these debt capital instruments, approval from the Reserve Bank of India (RBI) is required for debt servicing (including principal repayments) in case the bank reports a loss and is not liable to service the debt if it breaches the minimum regulatory capitalisation norms, i.e. CRAR of 9.0%. The coupon, if not paid, is non-cumulative.

Rationale

The revision in the rating outlook takes into account the breach in the regulatory capital ratio by Uttarakhand Gramin Bank (UGB). ICRA had earlier highlighted that the bank has large pension liabilities of Rs. 316 crore, which need to be provided for during FY2019-2023. UGB had provided Rs. 4.8 crore in FY2019 while Rs. 311 crore was required to be provided for till FY2023. These liabilities were sizeable in relation to its net worth (~153% of core equity capital – CET I) as on March 31, 2019. Further, the capital adequacy ratio (CRAR) was marginally above the regulatory requirement of 9.0% at 9.5% as on March 31, 2019 with limited cushion to absorb this liability. In FY2020, UGB made a provision equivalent to ~40% of the pension liability (including the unprovided part for FY2019), resulting in a high loss after tax of Rs. 77 crore (profit after tax of Rs. 15 crore in FY2019) and erosion in the CRAR to 6.1% as on March 31, 2020.

The rating reaffirmation continues to factor in UGB's strong parentage, held jointly by the Government of India (GoI; 50% holding), Government of Uttarakhand (GoU; 15%) and State Bank of India (SBI - 35%; rated [ICRA]AAA(Stable)). Further, UGB is incorporated under the Regional Rural Banks Act, 1976, under which dilution in the combined holding of the GoI and the sponsor bank (SBI) is limited to 51%, thereby ensuring sizeable direct or indirect sovereign ownership in UGB at all times. Moreover, regional rural banks (RRBs) remain strategically important to the GoI and state governments for meeting the credit demands of the agricultural sector. ICRA expects the requisite capital support to UGB in the current year to help it meet the regulatory capital ratios.

The rating also factors in UGB's deposit profile, which remains inherently granular given its rural presence, as well as the high share (56% as on March 31, 2020) of current account and savings account (CASA) in total deposits. The high share of CASA, coupled with the granular term deposit base, kept the cost of interest-bearing funds low at

4.80% in FY2020. Despite the lower cost of funds, UGB's weak capital position constrains its ability to improve the credit-deposit ratio, leading to subdued yields on assets and operating profitability.

The assigned rating has been withdrawn at the request of the bank and as per ICRA's policy on the withdrawal and suspension of credit ratings. The previous detailed rating rationale is available on the following link: [Click here](#)

Key rating drivers and their description

Credit strengths

Strong parentage ensured under RRB Act – UGB was incorporated under the Regional Rural Banks Act, 1976 and is jointly owned by the GoI (50% holding), GoU (15%) and SBI (35%). Legislative amendments introduced to the RRB Act in 2015 prevent the dilution in the combined holding of the GoI and the sponsor bank (SBI) below 51%, thereby ensuring sizeable direct or indirect sovereign ownership in UGB. Furthermore, under the Act, the GoI appoints the Chairman and two directors to the board while the state government is represented by two nominee directors. SBI, on the other hand, is represented by two directors nominated by it. Additionally, the board has representatives from NABARD and the RBI as board members. SBI and NABARD closely monitor the operational and financial performance of RRBs and extend supervisory support on a periodic basis.

Deposit profile characterised by high share of CASA and granularity – The rating also factors in the bank's deposit profile, which remains inherently granular given its rural presence, as well as the high share of CASA, which stood at 56% as on March 31, 2020 (marginally lower than ~57% as on March 31, 2019). The steady and strong CASA base, coupled with the granular term deposit base, helped maintain a low cost of interest-bearing funds at 4.80% in FY2020 (4.76% in FY2019). However, this was also driven by the steady CASA deposit growth and the limited need to mobilise term deposits, given the low credit-deposit ratio. If the bank receives capital and pursues credit growth, the incremental deposit mobilisation through term deposits will reduce the share of CASA deposits and push up the cost of funds.

Credit challenges

Profitability will remain weak till FY2023 because of sizeable provisions towards pension-related liabilities – Despite the lower cost of funds, UGB's profitability profile remains relatively weak owing to the weak asset quality metrics (GNPA at 7.49% and NNPA at 3.53% as on March 31, 2020) and high operating expenses mainly due to the high employee costs and the constrained scale of operations resulting from the weak capital position. However, even though the credit-deposit ratio was low at 42.2% as on March 31, 2020 (~43.3% as on March 31, 2019), the bank reported healthy net interest margins (NIMs) in FY2020 (3.28% in FY2020 against 3.41% in FY2019), supported by the lower cost of funds. The operating expenses (2.63% of ATA in FY2020 vis-à-vis 2.72% in FY2019) were high as the asset base is not commensurate with the branch network. This kept the pre-provision operating profit muted at 1.00% of ATA in FY2020 (1.04% in FY2019).

UGB had a total pension liability of Rs. 333 crore as per the actuarial valuation. While it provided Rs. 4.8 crore in FY2019 and ~Rs. 128.5 crore in FY2020, Rs. 199.98 crore is required to be provided for till FY2023. As of March 31, 2020, the unprovided pension liabilities remain significantly high in relation to the core capital (~159% vs ~153% in FY2019) and the operating profit (operating profit was 0.29 times the total of the unprovided pension liability). In addition, the NNPA stood at Rs. 82 crore as on March 31, 2020.

ICRA estimates that the bank's ability to provide for the pension liabilities through its operating profits remains limited as these liabilities need to be provided for by March 31, 2023 as per the regulatory requirements. As a result, UGB's internal capital generation will remain weak with a likelihood of losses unless it significantly scales up its operating profits by scaling up the business for which it has limited capital cushion. Additionally, a sizeable investment book (42% of the total assets) in G-Secs increases the sensitivity of the bank's profitability to movements in bond yields. With weak operating profitability of ~1.00% of ATA and credit costs of 0.29% (credit provision/ATA) against 0.85% in FY2019 and pension provisions, the bank reported a net loss of Rs. 77 crore (RoA of -1.34%) in FY2020 against a net profit of Rs. 15 crore (RoA of 0.28%) in FY2019.

Breach in regulatory capital ratios; immediate capital infusion required as internal accruals will remain weak – UGB's CRAR stood at 6.1% (CET I and Tier I at 5.4%) as on March 31, 2020 against the regulatory requirement of 9% (CRAR). Given the breach in the regulatory capital requirements, UGB will require immediate capital support of ~Rs. 70 crore to restore its capital ratios above the regulatory levels. Capital support is likely to be required in the coming years as well, given the weak operating profitability and the need to provide for the pension liabilities. With the erosion in the capital, the net leverage (net advances/net worth) increased to ~17.4 times as on March 31, 2020 (~10.2 times as on March 31, 2019).

Weak asset quality, given high geographical concentration and vulnerability to agro-climatic risks – RRBs were set up with a primary focus on meeting the credit demand of the rural and agriculture sector, with a district-defined role for each RRB. As RRBs operate within a limited number of districts or a single state, their overall scale and growth prospects remain limited, resulting in high geographical concentration of the loan book. UGB's loan book remains relatively diversified with the share of agriculture loans, industries, services, and personal loans at ~17%, 5%, 20% and 57%, respectively, of gross advances as of March 31, 2020. However, a sizeable exposure to the agriculture sector or agri-allied industries, coupled with the marginal profile of the borrowers, exposes UGB to agro-climatic risks, which could severely impact collections and lead to the deterioration of its asset quality metrics. The high GNPA levels witnessed in the agriculture segment (GNPA at 19.26% as on March 31, 2020) led to continued weakness in the bank's overall asset quality metrics with GNPA and NNPA at 7.49% and 3.53%, respectively, as on March 31, 2020, against 7.35% and 3.21%, respectively, as on March 31, 2019.

Limited diversity in products and earnings – UGB's product profile primarily comprises agriculture loans and loans to MSMEs. The limited product profile and the absence of avenues to scale up the fee-based income restrict the scope for improvement in UGB's income profile. Further, the contribution of UGB's fee-based income stood at ~0.4% of ATA for FY2020. However, this was generated largely by cross-selling SBI insurance products, adjusted for which, the fee-based income profile remains weak.

Liquidity position: Strong

UGB's granular liability profile is a positive from a liquidity perspective. Additionally, the bank's statutory liquidity ratio (SLR) remains much higher than the regulatory requirement of 18% with a major portion of its investments (which form ~42% of the overall assets as on March 31, 2020) parked in G-Secs that could be used for borrowings from the RBI (through REPO against excess SLR investments) apart from the marginal standing facility line from RBI. UGB can also avail refinance from NABARD. However, in addition to liquidity, the ability to service the rated instrument will also be driven by the bank's ability to maintain the capital ratios above the regulatory level.

Rating sensitivities

Not applicable as the rating has been withdrawn.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA Rating Methodology for Banks ICRA Policy on Withdrawal and Suspension of the Rating
Parent/Group Support	Not applicable
Consolidation/Standalone	Not applicable

About the company

Uttarakhand Gramin Bank (UGB) was established on November 1, 2012 when the erstwhile Uttaranchal Gramin Bank (sponsored by SBI) and Nainital Almora Khetriya Gramin Bank (sponsored by Bank of Baroda) were amalgamated into one entity. UGB's head office is in Dehradun. It has a network of 286 branches covering 13 districts in Uttarakhand.

UGB reported a loss after tax of Rs. 77 crore in FY2020 (PAT of Rs. 15 crore in FY2019) on a total asset base of Rs. 5,873 crore as on March 31, 2020 (Rs. 5,549 crore as on March 31, 2019), translating into an RoA of -1.34% (0.28% as on March 31, 2019).

Key financial indicators (audited)

(Rs. crore)	FY2019	FY2020
Net interest income	182	189
Profit before tax	21	(77)
Profit after tax	15	(77)
Net advances	2,168	2,310
Total assets*	5,549	5,989
% CET I	8.79%	5.39%
% Tier I	8.79%	5.39%
% CRAR	9.49%	6.12%
% Net interest margin / Average total assets	3.41%	3.28%
% Net profit / Average total assets	0.28%	-1.34%
% Return on net worth	6.99%	-58.35%
% Gross NPAs	7.35%	7.49%
% Net NPAs	3.21%	3.53%
% Provision coverage excl. technical write-offs	58.24%	54.77%
% Net NPA / Core equity	34.23%	64.87%

*Total assets and net worth exclude revaluation reserves

Source: Uttarakhand Gramin Bank, ICRA research

All calculations as per ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for past three years

Rating (FY2021)						Rating History for the Past 3 Years		
S. No.	Instrument	Type	Amount Rated	Amount Outstanding	Current Rating 03-August-20	FY2020	FY2019	FY2018
						17-Mar-20	-	-
1	Perpetual Debt Programme	LT	300.00 [^]	-	[ICRA]BBB-(hyb)(Negative); Reaffirmed and withdrawn	[ICRA]BBB-(hyb)(Stable); Assigned	-	-

[^] Yet to be placed
Amount in Rs. crore

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument details

ISIN	Instrument	Date of Issuance/ Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
-	Perpetual Debt	-	-	-	300.00 [^]	[ICRA]BBB-(hyb)(Negative); Reaffirmed and withdrawn

[^] Yet to be issued
Source: Uttarakhand Gramin Bank

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